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Order Instituting Rulemaking to Implement the
Commission's Procurement Incentive Framework and to
Examine the Integration of Greenhouse Gas Emissions
Standards into Procurement Policies.

Rulemaking 06-04-009
(Filed April 13, 2006)

**PRE-PHC COMMENTS OF ENVIRONMENTAL DEFENSE, NATURAL RESOURCES
DEFENSE COUNCIL, UNION OF CONCERNED SCIENTISTS AND WESTERN
RESOURCE ADVOCATES**

November 15, 2006

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1. Introduction and Summary

Environmental Defense (ED), Natural Resources Defense Council (NRDC), Union of Concerned Scientists (UCS), and Western Resource Advocates (WRA) respectfully submit these pre-prehearing conference (PHC) comments in accordance with the "Joint Administrative Law Judges' Ruling and Notice of Prehearing Conference" (ALJ Ruling), dated November 1, 2006.

NRDC is a non-profit membership organization with a long-standing interest in minimizing the societal costs of the reliable energy services that a healthy California economy needs. In this proceeding, we focus on representing our more than 131,000 California members' interest in receiving affordable energy services and reducing the environmental impact of California's energy consumption. Environmental Defense is a leading national nonprofit organization representing more than 500,000 members. Since 1967, we have linked science, economics and law to create innovative, equitable and cost-effective solutions to society's most urgent environmental problems. UCS is a leading science-based non-profit working for a healthy environment and a safer world. Its Clean Energy Program examines the benefits and costs of the country's energy use and promotes energy solutions that are sustainable both environmentally and economically. WRA is a regional environmental law and policy center serving the Intermountain West States. Its Energy Program has been active before state public utility commission and other state and regional planning forums promoting clean energy investments for over 15 years.

We commend the Commission for its leadership in protecting customers from the financial risks associated with global warming through its decisions over the past several years. In D. 06-02-032, the Commission stated its intent to establish a load-based cap on the utilities' global warming emissions. With the passage and signing of Assembly Bill (AB) 32, the Legislature and Governor strongly reaffirmed the Commission's leadership in addressing global warming, and built on the Commission's action by expanding the cap to encompass all emissions statewide.

In summary, our comments elaborate on the following points:

- We support the CPUC's plans to coordinate closely with CARB and other agencies;
- We recommend that the Commission utilize a workshop and comment process, rather than evidentiary hearings, and we expect to be active participants at the CPUC and at CARB;
- We urge the Commission to clarify terminology;
- We recommend that CARB adopt the reporting requirements, in consultation with the CPUC;
- Design of the declining cap and allowance allocation should be addressed together, and setting the aggregate emissions cap must be done in close collaboration with CARB;
- We recommend that CARB adopt the rules for any market mechanisms, with input from the CPUC;
- We urge the CPUC to consider compliance and enforcement mechanisms, and recommend that CARB establish a consistent penalty;
- A cap in the natural gas sector should be considered now and not deferred;
- It is premature to reevaluate the GHG emissions performance standard; and
- We agree that the economic analysis should evaluate the cost-effectiveness of options.

2. ED, NRDC, UCS, and WRA support the CPUC's plans to coordinate closely with CARB and other agencies

AB 32 provides the California Air Resources Board (CARB) with authority to adopt and enforce emission reduction measures, including limits on entities' emissions and market-based mechanisms to contribute to meeting the statewide 2020 emissions limit. Successful implementation of AB 32 in the utility sector will require close coordination among CARB, the CPUC, the California Energy Commission (CEC), the Independent System Operator (ISO), and the Climate Action Team (CAT). The bill explicitly states the intent of the Legislature for CARB to consult with the CPUC in developing "emissions reduction measures, including limits

on emissions of greenhouse gases applied to electricity and natural gas providers regulated by the Public Utilities Commission” (Health and Safety Code Section 38501(g)). While the CPUC should continue to implement the programmatic strategies that reduce greenhouse gas emissions (e.g., the efficiency programs, renewable portfolio standard, etc.), establishing limits on emissions and market-based systems will need to be done in especially close coordination with CARB. We commend the Commission’s plans to coordinate closely with all of the relevant agencies (ALJ Ruling, pp. 4, 10) and the Commission’s intent to have some of the outcome of this proceeding be used to help inform CARB’s AB 32 implementation efforts. (ALJ Ruling, p. 10)

3. Comments on the five programmatic areas

For each of the five programmatic areas outlined in the ALJ Ruling, the Commission asks parties to comment on: (i) the appropriate procedural process and need for evidentiary hearings, (ii) coordination among the CPUC and CARB, and (iii) the extent of parties’ planned participation. We begin with general comments on the five programmatic areas, and then address specific recommendations on some of the areas individually. In general, we recommend that the Commission utilize a workshop and comment process to address the issues in this proceeding, rather than evidentiary hearings. ED, NRDC, UCS, and WRA expect to be active participants in addressing all of these issue areas at the CPUC and at CARB.

A. We urge the Commission to clarify terminology

Based on our experience over the past few years in the Commission’s proceeding and the AB 32 legislative process, it has become clear that different parties involved in the discussion are using key terminology to mean different things. We strongly urge the Commission to begin this proceeding by clearly defining the terminology it is using.

The ALJ Ruling uses the terms “baseline,” “allowance allocation,” “emission reduction requirements over time,” and “cap structure and ratchet.” The precise meaning of these terms, and their inter-relationships, will have a significant impact on the best way to phase this proceeding.

For example, the term “baseline” appears to denote a cap on emissions based on a historical level of emissions. However, it is unclear whether it is intended to denote an aggregate cap on all load-serving entities’ (LSE) emissions, or an individual cap on each LSE. AB 32

requires that the state as a whole reduce emissions back to 1990 levels by 2020, but does *not* require that each individual entity return to its own 1990 level. If the term “baseline” is intended to denote an individual cap on each LSE it would, in effect, be equivalent to a decision to allocate allowances based on historical emissions; however, in D. 06-02-032, the Commission clearly intended to explore different allocation options further before ruling on a methodology. On the other hand, if the term “baseline” is intended to denote an aggregate cap on all LSE’s emissions, it is unclear how that is different from the “design of cap structure and ratchet” and why they are listed as separate issues. A third option is that the baseline could simply be for informational purposes to help inform the choice of the cap level. We recommend that consideration of historical emission levels (or baselines) be part of the process of setting the cap, along with other factors including the additional opportunities for LSEs to reduce emissions.

We also urge the Commission to clarify its use of terminology in setting a declining cap. There is a subtle, but important, difference between emission “reduction requirements” and emission “caps.” While the Commission appears to use them interchangeably, it would be helpful to clarify the Commission’s intent. An “emissions cap” is a limit on emissions, and actual emissions can be measured relative to that cap. However, “emission reduction” is generally used to describe the difference between actual emissions and the level of emissions that would have happened without an LSE’s action; but this metric is difficult to calculate because it is hard to know what emissions would have been under “business as usual” (since that cannot be measured). We recommend that the Commission focus on a “declining emission cap” or “declining emission limit,” both to be consistent with the terminology used in AB 32 and to establish a program that can easily be monitored and enforced.¹

B. Reporting requirements

AB 32 requires CARB to adopt a mandatory reporting program by January 1, 2008 for significant emitters of greenhouse gases, including all retail sellers of electricity. We recommend that CARB adopt the reporting requirements, in consultation with the CPUC, rather than the Commission adopting its own reporting requirements.² This is particularly important to ensure that the reporting requirements for all load-serving entities, including the municipal

¹ AB 32 uses the phrase “declining annual aggregate emissions limitations.” Health and Safety Code Section 38505(k)(1).

² For example, Attachment A question (e) asks “If the Commission adopts CCAR’s reporting protocols...” We urge the Commission to provide input on reporting protocols to CARB, but to leave formal adoption of the protocols to CARB.

utilities, are the same. The CPUC could assist CARB in collecting information from LSEs and input from parties (on the good list of questions in Attachment A to the ALJ Ruling), synthesizing that input, and by providing recommendations to CARB; however, there does not appear to be enough time for the Commission to do that through a formal CPUC decision. The schedule outlined in the ALJ Ruling would envision a final CPUC decision on reporting issues in the 3rd or 4th quarter of 2007; however, CARB will need input earlier in the year in order to incorporate it into their ruling by January 1, 2008.

In parallel with the reporting work at CARB, we recommend that the CPUC proceed to implement the requirement in D.06-02-032 that all power purchase agreements that the utilities sign require reporting of emissions (as noted on page A-1 of the ALJ Ruling). In addition, we urge CARB, the CPUC, CEC, and ISO to work together to further explore the “region-wide generation attribute tracking system” discussed in question (i) in Attachment A of the ALJ Ruling. Establishing such a system will be essential to enable a functioning load-based cap on emissions in the electric sector.

C. Declining cap and allowance allocation

The ALJ Ruling outlines two separate tracks for “baseline development and allowance allocation” and “design of cap structure and ratchet.” As we discussed above, based on our understanding of the meaning of these terms, these issues are interdependent and may be best addressed together.

Assuming that the basic structure of the program under development in this proceeding will require each LSE to surrender or retire enough allowances each compliance period to match their emissions during that period, there are two basic approaches that can be used to determine each LSEs’ responsibility. One option is a “bottom-up” approach, where a “cap” is determined for each entity (which implicitly decides the allocation of allowances, since a cap is essentially a permit to emit up to that limit), and then the rate of decline in each entity’s cap is determined. The second option is a “top-down” approach, to determine an aggregate cap for all LSEs, the decline in that cap over time, and then to decide how to allocate the allowances among the LSEs. It is unclear which of these approaches is envisioned in the ALJ Ruling (or if there is another option we are not understanding), because of the confusion in terminology discussed above.

As we noted above, we do not believe the Commission needs to rule on “baselines.” We recommend that consideration of historical emission levels (or baselines) be part of the process

of setting the cap, along with other factors such as the additional opportunities for LSEs to reduce emissions. As such, we suggest removing “baseline development” as a key issue area, and instead including it as one consideration in the section on establishing a declining cap.

To comply with AB 32, CARB will need to be confident that all sectors are making an appropriate contribution to ensure that the state does not exceed the statewide emissions limit. As such, the most important issue that requires close collaboration with CARB is setting the aggregate cap on emissions (for all LSEs) and the decline of that cap over time (whether that is done through a “bottom-up” or “top-down approach”). We do not have a preference with regards to whether the CPUC or CARB takes the lead to address this issue. However, if the CPUC adopts the caps, close coordination and agreement with CARB will clearly be essential since CARB will retain the authority to set a more stringent cap.

The determination of each LSE’s responsibility within an aggregate cap is more conducive to a primary role for the Commission, if the CPUC and CARB so desire, because it will have fewer implications for the emission reductions required by other sectors in the overarching program that CARB will be establishing. However, close coordination with CARB will remain important to ensure that the publicly-owned utilities not subject to CPUC jurisdiction will be part of a comparable program at CARB.

We recommend that the Commission address these issues through a process of comments, workshops, workshop report and/or straw proposal, followed by a final round of comments. We do not anticipate a need for hearings.

D. Flexible compliance mechanisms

We understand “flexible compliance mechanisms” to encompass consideration of market mechanisms, such as trading and offsets, as well as other flexibility mechanisms that can smooth out variations in emissions over time such as banking and borrowing. In order to have a functioning market system in California, the market rules must be consistent across all sectors. Therefore, we recommend that CARB adopt the rules for any market mechanisms, with input from the CPUC and all parties. The comment process and modeling envisioned in the ALJ Ruling could help inform CARB’s decision.

While it is preferable that any other flexible compliance mechanisms (e.g., banking) be consistent across all sectors under the cap that are linked by market mechanisms, it is not as important that they be identical. Mechanisms to smooth variations in emissions over time are

particularly important in the electric sector (due to weather and hydropower availability variations). Therefore, the Commission should devote its efforts to analysis and consideration of these types of flexible mechanisms.

E. Compliance and enforcement mechanisms

We urge the Commission to add consideration of compliance and enforcement mechanisms to the list of issues that need to be addressed to implement this program. This issue was raised in D.06-02-032, and is noted in question number 9 in Attachment A of the ALJ Ruling, however, it is unclear where it fits into the draft schedule in Attachment B. The compliance and enforcement mechanisms will need to be addressed in close coordination with CARB, particularly since it may be most efficient to have a single statewide entity tracking compliance in all sectors subject to limits. In addition, we recommend that CARB establish a consistent penalty for all entities subject to a cap in sectors that are linked by market mechanisms (e.g., a fine of \$X per ton and surrender Y times the number of missing allowances the following compliance period), in order to ensure that allowances have comparable value in all sectors.

4. A cap in the natural gas sector should be considered now and not deferred

The natural gas sector accounts for about 15% of the state's greenhouse gas emissions, making it the third largest source of emissions in the state, behind the transportation and electric sectors. Limiting emissions from the natural gas sector will therefore be essential to meet AB 32's statewide limit. It is unclear whether the ALJ Ruling intends to include the natural gas sector in its consideration of each of the issue areas outlined in Attachment B. The ALJ Ruling states that the Commission intends to "undertake a broad investigation on issues related to the electric and natural gas sectors..." (p. 4), however, question 11 in Attachment A seems to imply that the natural gas sector will be addressed in some future phase of the proceeding.³ We urge the Commission and CARB to consider a cap system in the natural gas sector as part of the process outlined in the ALJ Ruling and in CARB's 2009 scoping plan, and not defer it to a later date.

³ "11) Define the steps to take to ensure that GHG emissions associated with customer use of natural gas are incorporated into a procurement incentive framework for the future."

5. It is premature to reevaluate the GHG emissions performance standard

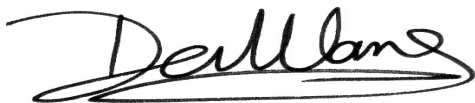
The ALJ Ruling proposes to include consideration of “whether a GHG emissions performance standard should be adopted as a permanent complement to a load-based GHG emissions cap and, if so, the design of such a standard” within the scope of Phase 2 of this proceeding. (p. 2) We believe this is premature. Senate Bill 1368 (Perata) calls for reevaluation of this standard “when an enforceable greenhouse gases emissions limit is established *and in operation...*” (Public Utilities Code Section 8341(g), *emphasis added*). The emissions limit will not be in operation for several more years, and therefore it is premature for the Commission to reevaluate the emissions standard prior to that time.

6. We agree that the economic analysis should evaluate the cost-effectiveness of options

We support the ALJ Ruling’s determination that a cost-effectiveness analysis of different implementation options will be more useful to parties than a cost-benefit analysis. In addition, the Climate Action Team and CARB have done, and will continue to do, macro-economic analyses of meeting the overall statewide limit. Modeling of specific electric sector policy options should be done in close collaboration with CARB, and should include the entire electric sector.

Dated: November 15, 2006

Respectfully submitted,



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On behalf of:

Environmental Defense [Virgil Welch]
Union of Concerned Scientists [Cliff Chen]
Western Resource Advocates [Eric Guidry]

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the **“Pre-PHC Comments of Environmental Defense, Natural Resources Defense Council, Union of Concerned Scientists, and Western Resource Advocates in the matter of R.06-04-009** to all known parties of record in this proceeding by delivering a copy via email or by mailing a copy properly addressed with first class postage prepaid.

Executed on November 15, 2006 at San Francisco, California.



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